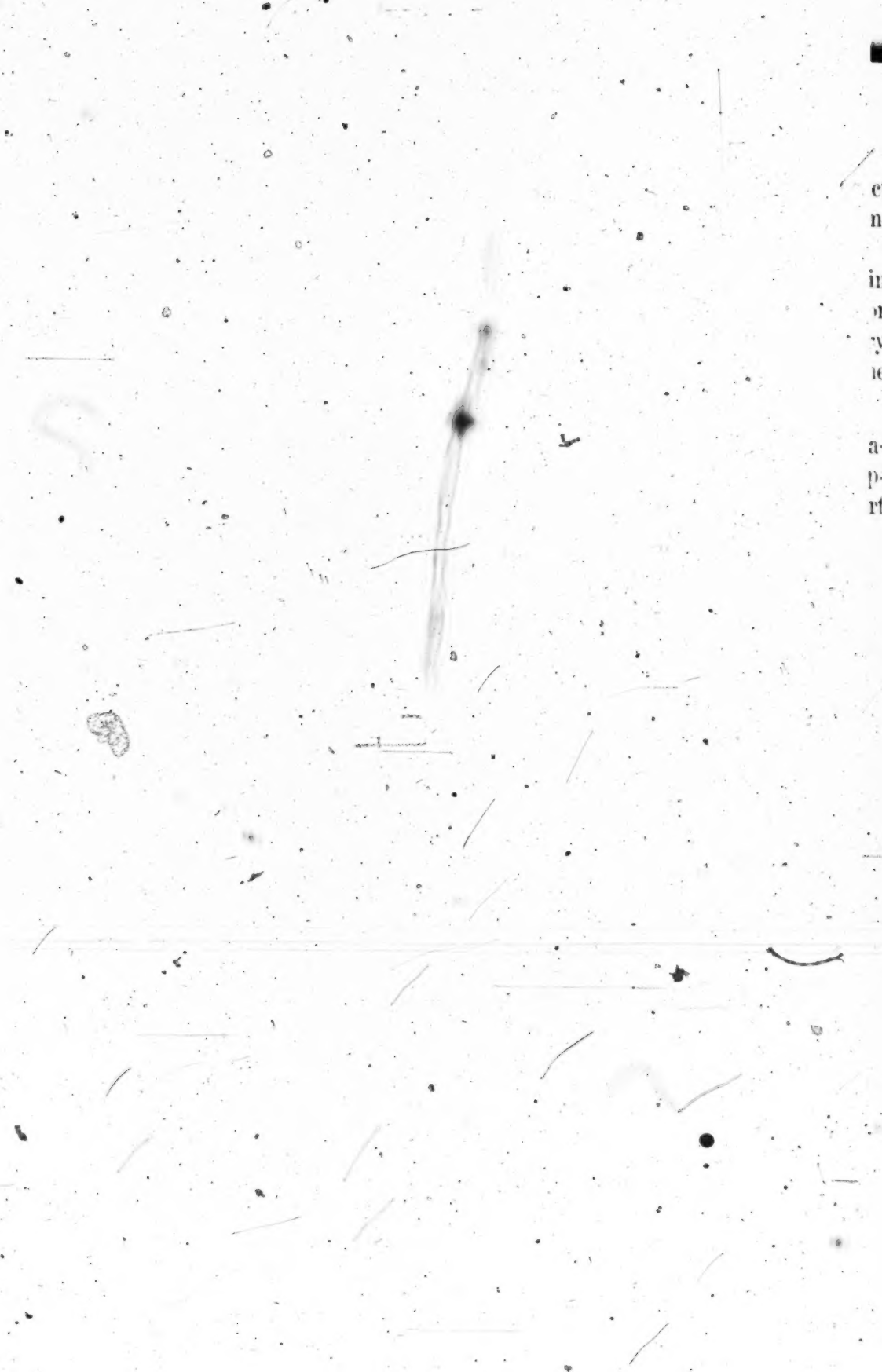

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1939.

Nos. 23 and 24.

In the Matter of

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Debtor.

THOMAS K. CASE and ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Respondent.

PETITION OF RESPONDENT FOR REHEARING.

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vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Respondent.

PETITION OF RESPONDENT FOR REHEARING.

To the Honorable Charles Evans Hughes, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the United States:

Respondent files this petition for rehearing and briefly states its grounds therefor as follows:

Summary of Statement of Grounds for Rehearing as Requested by Paragraph 2(f) of Rule 27.

POINT I.

We Submit That This Honorable Court Erred in Concluding That the Respondent Corporation, a Legal Entity Distinct From the Class A Stockholders, Could, by the Commencement of the 77B Proceeding, Waive the Vested Right of the Class A Stockholders to Insist That the Bondholders Live Up to Their Contract Not to Foreclose the Bonds Until 1944, Which Right, Among Others, Was Obtained by the Class A Stockholders Under the Reorganization Agreement of 1930, at a Cost to Them of $400,000.00.

The Class A stockholders of respondent corporation, as such, have a separate and distinct legal status and are in no way identical with respondent corporation. As to them, the respondent corporation is a separate—and may be an antagonistic—legal entity. In addition to their rights as stockholders under the articles of incorporation, the Class A stockholders obtained, at a cost of $400,000.00, by virtue of the 1930 reorganization agreement—and still have—a vested right to insist that the bondholders do not foreclose until 1944 the trust indenture securing the corporation's bonds. Respondent corporation, by voluntarily filing a petition under Section 77B, could not waive, on behalf of the Class A stockholders, or otherwise affect, a valid and existing contract between these particular stockholders and the bondholders unless these stockholders consented, expressly or impliedly. *No such consent has ever been given, nor has the respondent corporation, or any one else, ever been authorized*

by the Class A stockholders to give such consent. The conditional consent to the proposed plan of reorganization of only a part of the Class A stockholders was expressly based upon their receiving the stock allotment provided in that plan, which was ultimately approved by the District Court. Neither the respondent corporation, nor the Court, had the power to alter that plan without the requisite consent of the Class A stockholders as a class.

We respectfully submit that when the Congress, in adopting Section 77B, stated, in subdivision (e)(1) thereof, that a plan of reorganization "shall not be confirmed until it has been accepted in writing * * * by or on behalf of stockholders of the debtor holding a majority of the stock of each class, * * * provided, however, that such acceptance shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders if the judge shall have determined * * * that the debtor is insolvent, * * *", it was referring to stockholders having the usual rights arising under the articles of incorporation and was not referring to a situation such as is involved in this case, where the Class A stockholders have, in addition to the usual rights arising under the articles of incorporation, a vested contractual right as against the bondholders of the respondent corporation and as against the respondent corporation itself, acquired by the payment of a large sum in cash.

This Honorable Court, in its decision of November 6, 1939, holds that this vested contract right—which belonged to the Class A stockholders as a class and for which they paid $400,000.00—was waived on their behalf by respondent corporation when it filed the petition for

reorganization under Section 77B. It is respectfully submitted that such a conclusion does not do equity and is untenable. In what way may it be said that these particular stockholders waived or gave up this valuable right? There is nothing in the record indicating that the respondent corporation, or its board of directors, was ever authorized by the Class A stockholders to waive or surrender that right.

How can it be said that any plan of reorganization will be fair and equitable which abrogates completely this vested contract right of the Class A stockholders—not only without adequate compensation but also without any compensation, and even without submitting the matter to them for their consideration?

Proceedings in reorganization under Section 77B are proceedings in bankruptcy. *Schwartz v. Irving Trust Co.*, 299 U. S. 456, 462. An adjudication in bankruptcy absolves from no agreement, terminates no contract, and discharges no liability, and the same is true of the approval of a debtor's petition for reorganization under Section 77B. *Johnson v. Kurn* (C. C. A. 8, 1938), 95 Fed. (2d) 629, 36 A. B. R. (N. S.) 418. But, in the opinion filed by this Honorable Court in connection with its decision of Nov. 6, 1939, the broad position is taken that the otherwise valid vested contract rights of the Class A shareholders were wiped out by the institution of the 77B proceeding by the debtor corporation itself. We submit that these vested rights could only be diminished, or wiped out, by these shareholders themselves, as a class, by the composition method provided by Section 77B-(e)-(1), *i. e.*, by a majority vote of the stock of that class of shareholders, with the concurrence of the district judge that the plan is fair

and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible (Section 77B-(f)). Otherwise, we submit that any plan which wiped out or ignored without their consent, these shareholders, who held such vested contract rights, would be invalid because it violated the Fifth Amendment to the Constitution of the United States. *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 28 A. B. R. (N. S.) 397, 55 S. Ct. 854, 79 L. Ed. 1593; *Tennessee Publishing Co. v. American National Bank* (C. C. A. 6, 1936), 81 Fed. (2d) 463, 30 A. B. R. (N. S.) 521, 299 U. S. 18, 81 L. Ed. 13, 57 S. Ct. 85, 32 A. B. R. (N. S.) 180.

This Honorable Court also holds that the District Court obtained jurisdiction over the *res* when it approved, as properly filed, the petition under Section 77B. But what was that *res*? It was the physical properties of the respondent corporation, not free and clear, certainly, but charged with the obligations of the trust indenture securing respondent's bonds. One of the then valid and existing provisions of this trust indenture prevented, until 1944, a foreclosure because of nonpayment of interest and unless an event of default remained uncorrected after notice thereof. No such event of default has occurred. Was it fair or right for this Honorable Court to assume that other events of default might have occurred when such was not the fact, and when the District Court, after meticulous consideration of the entire matter, as shown by the record, found no such default? [R. p. 208.] We would also respectfully urge that the moratorium against foreclosure until 1944 was not only as a result of the contract between (1) the respondent corporation, (2) the bondholders, and (3) the Class A stockholders, but was

also made a part of the bond issue trust indenture by proper amendment [R. p. 321].

May we also respectfully submit that the District Court did not permit participation by Class A stockholders because of the "nuisance value" of their position, but because they had a valuable vested right, which the Court felt it fair and equitable to recognize.

POINT II.

If the Court Will Rule at This Time Upon Two of the Main Contentions of Petitioners Case and Cowan, Future Litigation Based Thereon in This Proceeding May Be Avoided.

Petitioners Case and Cowan claim:

That they are in a class by themselves as the only remaining *bona fide* holders of first mortgage bonds of respondent, are entitled to have the lien of the trust indenture enforced and their bonds paid in full, and that any other treatment of them would be violative of the rights vouchsafed to them in their bonds and under the trust indenture if accomplished by amendment of the trust indenture and would not give them "adequate protection" if done under Section 77B for the following reasons:

(1) That they have never consented as bondholders to any reorganization of respondent, either the voluntary one in 1930 or the present proceeding under Section 77B;

(2) That no majority consent of bondholders, however large, whether pursuant to the amendment provisions of the trust indenture as in the 1930 reorganization or pursuant to the provisions of Section 77B as in the present proceeding can bind them.

Respondent, on the contrary, claims:

(1) That the bond issue trust indenture was amended in accordance with the amendment provisions thereof in 1930; and

Therefore petitioners, even though among the minority of bondholders not consenting thereto, were bound by said amendment;

(2) That in a proceeding under Section 77B the District Court is empowered to approve a plan which has been consented to by the holders of the requisite percentage of bonds in the class if the plan is found to be fair and feasible and not discriminatory in favor of any class; and

Therefore petitioners, even though among the minority of non-assenting bondholders of the class of which the requisite majority in amount consented thereto, would be bound by such plan, notwithstanding the fact that their rights are materially altered under such a plan; and

(3) The provisions of subdivision (b)(5) of Section 77B are not applicable where the confirmed plan has been consented to by the holders of the requisite amount of bonds in the class.

The District Court ruled in favor of respondent on all of these points [R. pp. 108, 219, 228, 244, 313, 321, 328] and the holding was not disturbed by the Circuit Court [R. pp. 374, 376-380]. Respondent respectfully submits that the decision of this Honorable Court does not decide these points and therefore petitioners or any other bondholders of respondent similarly situated will not be barred from raising the same questions again in this proceeding, regardless of whatever plan which treats all of respondent's bondholders alike may ultimately be approved by the District Court and consented to by the requisite percentage of security holders of respondent.

ARGUMENT.

POINT I.

We Submit That This Honorable Court Erred in Concluding That the Respondent Corporation, a Legal Entity Distinct From the Class A Stockholders, Could, by the Commencement of the 77B Proceeding, Waive the Vested Right of the Class A Stockholders to Insist That the Bondholders Live Up to Their Contract Not to Foreclose the Bonds Until 1944, Which Right, Among Others, Was Obtained by the Class A Stockholders Under the Reorganization Agreement of 1930, at a Cost to Them of $400,000.00.

The facts of the 1930 voluntary reorganization of respondent are set forth in the appendix to respondent's brief in opposition to petition for writ of certiorari and in the opinion of this Honorable Court. Respondent however, deems it necessary and of great importance to again analyze and consider the contract entered into in 1930 between the Class A stockholders of respondent as a separate and distinct group apart from respondent, as an entity, and the bondholders of respondent, as a group. This contract or voluntary plan of reorganization in 1930 was as follows:

The Class A stockholders of respondent contributed $400,000 to respondent as new working capital. In consideration for this new capital the bondholders agreed to and did or cause to be done the following: The trust indenture was amended to reduce the interest and make it payable only if earned and those of the contributing stockholders subject thereto were released from any possible stockholders' liability for the payment of the bonds under the California law then in existence.

The bondholders, by virtue of this contract, gained the benefit of $400,000 of new working capital in respondent corporation or its subsidiary and the Class A stockholders gained, by this contract, a vested right to postpone foreclosure of the trust indenture until 1944 and a release of stockholders' liability on the bonds.

This contract right postponing foreclosure until 1944 was acquired for said valuable consideration by the Class A stockholders from the bondholders, each of these groups being distinct and apart from each other and from respondent as an entity. This right was also acquired from the respondent corporation as a consideration for the payment into the treasury of the $400,000. The Class A stockholders paid for this right. It was theirs and did not belong to respondent. We submit that respondent had no power to change or affect this vested right in any way by waiver or otherwise. As fully discussed in other briefs, the plan of reorganization of 1937, now before this Court, was developed and promulgated by respondent after extended negotiations among the officers of the respondent corporation, the bondholders, and the Class A stockholders. To the corporation's directors was left the power to decide whether to consummate the reorganization with or without a 77B proceeding, but whichever way was chosen, the conditions were the same, so far as the rights of the Class A stockholders were concerned.

As we have repeatedly pointed out, the Class A stockholders were vested with a valuable right, which would have to be abrogated if an immediate reorganization were to be effected. Nothing was due to the bondholders on account of their bonds. They could not foreclose the

trust indenture, or obtain relief thereunder, until 1944. The right to postpone foreclosure did not arise in favor of the Class A stockholders out of the articles of incorporation of respondent; that right grew out of and was based on the 1930 contract between the bondholders and the Class A stockholders [R. pp. 76, 87, 227, 228, 313]. Under the 1937 plan of reorganization, confirmed by the District Court, the bondholders said to the Class A stockholders, in effect: "If you will now give up this valuable right to postpone foreclosure, we will consent to a plan of reorganization of respondent corporation which will give you participation in the reorganized company. That will be your compensation for giving up this right and agreeing to this plan." In consideration of such participation, this proposition was accepted and agreed to by more than ninety-eight per cent (98%) of the Class A stockholders.

Respondent promulgated the 1937 plan in good faith [R. pp. 244, 328]. Its board of directors decided that there were not consents of bondholders, close enough to 100 per cent to consummate the plan by the voluntary route. Therefore a 77B proceeding was inaugurated [R. pp. 80, 313]. We submit that this act on the part of respondent corporation could not divest the Class A stockholders of any vested contract right, nor could it create or change the powers of the District Court under Section 77B to pass upon all of the rights of stockholders and security holders of respondent and upon the fairness and equitableness of the plan. The plan and the participation of the Class A stockholders was at all times subject to the ultimate approval of the court. Vigorous representation was made as to the merits and demerits of the plan before the Court during the proceedings [R. pp. 307, 308]. The findings of the District Court

and the District Court's decision show the exactness and thoroughness with which all phases were inquired into. The District Court found this vested contract right of the Class A stockholders to be valid and to exist, and petitioners accepted this decision and did not question it on this appeal. The District Court [R. pp. 227, 228, 321] evaluated that vested contract right and decided that the forebearance of the Class A stockholders or the giving up by them of their right to delay foreclosure until 1944 was the principal consideration passing from them to the bondholders to justify the participation of these stockholders under the plan and was in all respects adequate and fair.

Respondent submits that the decision of this Honorable Court now rests squarely on the basis that whatever right the Class A stockholders had under the 1930 contract, and under the 1937 plan of reorganization, was waived or abandoned on their behalf by *respondent corporation* when the jurisdiction of the District Court was invoked by the respondent corporation *alone*. This ground for this decision, we respectfully urge, is neither justified by the equities of the situation, nor is it sound logically. To maintain such a theory, this Honorable Court must find in respondent corporation the power to waive or abandon the contract right vested in the Class A stockholders. Such power in respondent corporation must have been created by the Class A stockholders, or must have arisen from circumstances which would force a court of equity to look through the "corporate veil", disregard the separate entities and hold that respondent corporation and its Class A stockholders are one and the same. It must then hold that the power to waive or surrender a vested contract right, which theretofore existed in the Class A

stockholders alone, after the petition in 77B was filed, also existed in respondent corporation.

On the first alternative—we look in vain for any authority granted by Class A stockholders to respondent corporation to waive, surrender, or abandon their vested right. The 1937 reorganization plan, confirmed by the District Court, was based on the agreement of the Class A stockholders to give up their right to postponement of foreclosure until 1944 upon receipt of twenty-three per cent (23%) of the common stock of the new company, and the consideration therefor was to pass to them upon the consummation of the plan. The Class A stockholders, as a class, had to agree first, before any step could be taken to reorganize the bondholders. This plan immediately gave the assets to the new company and gave the bondholders, as preferred stockholders, the practical equivalent of foreclosure. This saved to the bondholders all of the expensive burdens of complying with the trust indenture during such period, as well as the expense and burden of a foreclosure proceeding. Surely nothing would be more inequitable or untenable than a holding that, when the consideration for a contract consists of the surrender of a right by the first party for which the second party agrees to pay, and by which he obtains an advantage, the second party may retain the advantage of the surrender and not be required to make the agreed payment therefor.

The 1937 plan recognized the 1930 contract, wherein the vested contract right was created between the Class A

stockholders and the bondholders. The 1937 plan provides a 77B proceeding as an alternative method of consummation, but, we submit, it grants no authority to respondent corporation to surrender or waive the vested contract right of the Class A stockholders granted to them in 1930. On the contrary, it reassures and guarantees to the Class A stockholders that upon the consummation of the plan these stockholders will be compensated and be permitted to participate in the reorganized company as the consideration for the surrender by them of their vested contract right to postpone foreclosure until 1944. The District Court, we submit, would have violated the provisions of Section 77B had it failed to take into consideration the relative classifications of the Class A stockholders, the Class B stockholders, and the bondholders under the 1930 contract, and any plan which failed to adequately compensate the Class A stockholders for the abrogation of their vested right acquired thereunder would not, we submit, be fair and equitable.

On the second alternative—does there exist in the present case a set of circumstances making it necessary for a court of equity to disregard the separate entities of the Class A stockholders and respondent corporation to avoid an inequitable result? We submit that the very statement of the case forces a conclusion that this proceeding is one which requires a segregation of the corporate entity from the Class A stockholders, as a group, to produce a fair and just result.

The California cases are numerous supporting the proposition that the stockholders of a corporation have a separate status distinct from the corporate entity. Some of the late cases are the following:

Erkenbrecher v. Grant (1921), 187 Cal. 7, 11;

Wood Estate Co. v. Chanslor (1930), 209 Cal. 241, 245;

Cleaning & Pressing Co. v. Hollywood Laundry Service (1932), 217 Cal. 124, 129;

Dos Pueblos Ranch & Improvement Co. v. Ellis (1937), 8 Cal. (2d) 617, 621.

This ruling will be followed by the Federal Courts.

In re Sterling (C. C. A. 9, 1938), 97 Fed. (2d) 505 (cert. den. 83 L. Ed. 22);

Erie R. R. Co. v. Tompkins (1938), 304 U. S. 64, 82 L. Ed. 1188, 58 Sup. Ct. Rep. 817.

We submit, therefore, that the 1930 plan of reorganization vested in the Class A stockholders, independent and distinct from respondent corporation, a contract right to postpone foreclosure under the bond issue trust indenture for anything short of failure to pay interest, if earned, until 1944. Under the 1930 plan, the voting control of respondent, through its board of directors, was vested in George A. Armes *at the instance of the bondholders* [R. pp. 101, 313]. It is submitted that if Section 77B had been in existence immedately after the consummation of the 1930 plan, the then board of directors of the respondent corporation could not have effectuated a plan which would have been tantamount to foreclosure of the bonds, without the consent of the Class A stockholders, by Section 77B or any other means, and that by the same token, the

respondent corporation can not now, by taking advantage of Section 77B, bring about the same result, that is, the abrogation of the vested right of the Class A stockholders to prevent foreclosure, without adequately compensating such stockholders therefor.

The District Court, in July of 1938 [R. p. 208], found and held:

> "The evidence shows that the bondholders are not now in a position to foreclose because, by the terms of the amended trust indenture, no default can be predicated upon a failure to pay interest unless earned—and that the interest has not been earned. This relief from the possibility of a default under the bond issue was one of the main considerations, running to the Class A stockholders when the additional capital of $400,000 was provided.'"

We respectfully submit that it is untenable that the bondholders should now be permitted under a plan of reorganization of respondent corporation in a Section 77B proceeding to disregard the right of shareholders to postpone foreclosure until 1944 and to do what is tantamount to effecting foreclosure of the bond issue trust indenture at this time. That any procedure based on such a plan would be unfair and inequitable was the decision of the District Court. Respondent submits, however, that the bondholders are granted such right by the decision of this Honorable Court, and by said decision the Class A stockholders are divested of their right to have foreclosure postponed until 1944 without any compensation therefor whatever, and without their consent, or the consent of any of them. We submit that any plan now filed by the bondholders, where they seek to possess themselves of the entire assets of the respond-

ent corporation and thereby to bring about the effective results of foreclosure of their bonds, would not be a plan of reorganization but would be an attempt to obtain foreclosure by a short cut and, hence, would not be filed in good faith, and for that reason, could not be approved by the District Court.

For the purpose of a further analysis of this Honorable Court's decision, let us assume a reorganization situation where there is no vested contract right in the stockholders but merely their usual rights arising under the articles of incorporation, as follows:

A corporation has stock and bonds outstanding with all of its existing and after-acquired assets subject to the lien of the bond issue indenture. The value of its assets is $830,000.00, which is less than the amount of the bonded indebtedness by more than $400,000.00. The corporation requires $400,000.00 cash immediately as working capital and to save valuable assets and under a plan of reorganization approved by substantially all of its stockholders and bondholders the stockholders agree to and do immediately advance $400,000.00 to the corporation as a contribution to capital because of the dire need therefor and *prior* to the commencement of the 77B proceedings, but with the provision in the plan that the stockholders are to receive a minority and junior stock position in the reorganized company, the bondholders being accorded a prior stock position. Under the circumstances so assumed *and apart from the plan*, when the corporation files its 77B petition, the rights of all stockholders and all creditors *as such* (other than the bondholders) will be wiped out because the assets subject to the lien of the bond issue indenture will be less than the amount of the bonded indebtedness.

When applied to these assumed facts, the decision of this Honorable Court in the instant case would force a District Court to find the plan unfair because the $400,000.00 was advanced by the stockholders shortly prior to the institution of the 77B proceedings and all rights of stockholders were waived by the corporation by the filing of the 77B petition, whereas the same plan could properly be found to be fair and equitable had the $400,000.00 in cash been advanced immediately after the institution of the 77B proceeding.

We submit that the time when the new contribution is made, if it is made pursuant to a plan, is immaterial in the determination of the question of the fairness of the plan. The question should be decided by the District Court on the basis of whether the contribution was adequate and not on the question of whether it was made before or after the institution of the 77B proceeding. Further, even under the facts of the assumed case, where the stockholders' only rights were under the articles of incorporation, we would also urge and contend that the decision of the District Court on the fairness of the plan should not turn or be based upon the proposition that technically the stockholders' rights were lost or waived by the institution by the corporation of the 77B proceedings.

We do not contend that a District Court is in anywise precluded from passing on the fairness of a plan because it was approved by a large majority of all affected security holders prior to the institution of the 77B proceedings. *We do not contend* that a District Court is in anywise bound to follow such a previously approved plan if it is in fact unfair. *We do contend* that if a plan entered into prior to the institution of the 77B proceedings was mani-

festly fair when it was entered into, because each group participating therein contributed an adequate consideration for its participation in the plan, and such plan provided for its consummation in 77B proceedings, the institution of the 77B proceedings should not be held to cause the plan to become unfair by reason of the fact that if it were not for the provisions of the plan, the value of the consideration given by one group of participants would ordinarily have been wiped out under the rules applying to bankruptcy claims.

Now we revert to the instant case pending before this Honorable Court. We contend: First, the respondent corporation could not waive the existing vested contract right in the Class A stockholders which arose out of the 1930 plan of reorganization; and, second, that even apart from the inability and lack of power in the respondent corporation to waive such right, the institution of a 77B proceeding whether by a debtor or security holders of debtor, should never be held to have the effect of making unfair a plan which was fair immediately prior to the institution of such proceedings and which plan provided for its consummation in the 77B proceedings.

We have discussed elsewhere the findings of the special master and the District Court as to the adequacy of the consideration flowing from the Class A stockholders to justify their participation under the plan. The forbearance to exercise a right may be just as valuable a consideration as a contribution in money. The Class A stockholders had a right to prevent foreclosure until 1944, a period of eight years, at the time the 1937 plan was formulated in the spring of 1936. That the forbearance or waiver of the right was equal in value to the participation

afforded under the plan to the Class A stockholders was found to be a fact by the special master, by the District Court and by 90-plus per cent of the bondholders. The record of the evidence upon which this finding is based is not before the Court and petitioners Case and Cowan did not question this finding. This Honorable Court, in its decision, held that the conclusion of the District Court that the virtual abrogation of the agreement deferring foreclosure until 1944 justified participation by the stockholders in the plan was erroneous and the basis for the error as pointed out by this Honorable Court was that the consideration had been waived. We do not interpret the language used by this Honorable Court in its decision to convey the meaning or the holding that if there had been no waiver, the consideration would not have supported the issuance of the stock. In respondent's supplemental brief in opposition to petition for writ of certiorari, we called this Court's attention to the decision of the Circuit Court of Appeals for the 7th Circuit in *In re Georgian Hotel Corporation*, 82 Fed. Rep. (2d Series), p. 917, in which case this Honorable Court denied certiorari in 298 U. S. 673. From the reported decision of the Circuit Court in 82 Fed. Rep. (2d Series) at page 919, it would appear that the consideration which was the basis of the allotment of a 30% stock interest to subordinate creditors was a waiver of a statutory right of redemption which would have been vested in said subordinate creditors for a few months upon a foreclosure of the first mortgage. We cited this decision because the facts as to the consideration were similar to the instant case in that in both situations the consideration arose from the waiver of a right. We also believe that the Circuit Court for the 7th Circuit was correct in its conclusion when it left the determination of the adequacy of the

consideration flowing from the subordinate creditors to the judicial discretion of the District Court.

This is not a case of the stockholders at the last minute conjuring up a "nuisance value" to prevent or delay a foreclosure or a 77B reorganization. The vested right upon which the Class A stockholders' claim is based was created in 1930 for the valuable consideration of $400,000. It has existed in the Class A stockholders and been recognized and lived up to by the bondholders through all these years. Neither litigation nor attempted foreclosure, we submit, could disturb the vested right to postpone foreclosure until 1944 as it existed in the Class A stockholders. These stockholders had to be persuaded in some way voluntarily to surrender and abrogate this right. It was upon this basis that the 1937 plan of reorganization was conceived and promulgated by the respondent corporation and confirmed by the District Court. We submit that the decision of this Court works an inequitable result and a wholly unfair disposition of the vested contract right of the Class A stockholders.

We submit that the case at bar is one such as was discussed at page 17 of the opinion of this Honorable Court, wherein the Court recognizes that settlements of honest differences and conflicting claims do not constitute a bowing of the District Court to nuisance claims, but, rather, a consideration of the reorganization proceedings in an economical and practical manner. We respectfully urge that the position taken by this Court is untenable when it states that "any strategic position occupied by the stockholders prior to these proceedings vanished once the Court invoked its jurisdiction". This position is logical and tenable if the

rights of the stockholders in a proceeding arose solely out of the articles of incorporation of a debtor, but not, we submit, when the right of the stockholders arose, as here, under a contract independent and separate from the articles of incorporation. Respondent submits that the vested contract right of its Class A stockholders to postpone foreclosure did not vanish when respondent corporation filed its 77B petition.

As pointed out in other briefs, respondent agrees with the views of this Honorable Court expressed in *In re 620 Church Street Building Corp.*, 299 U. S. 24, and has never argued that stockholders of an insolvent debtor should be granted participation except and unless they present adequate consideration therefor. We would not object to this Court's decision in the instant case if the Class A stockholders' rights arose only from the articles of incorporation of respondent. In those circumstances we would say, with Mr. Justice Douglas, that when the Court's jurisdiction is invoked, the junior stockholder interest "assumes all the consequences which flow from that jurisdiction". We do wish to urge, however, with all of the earnestness and strength at our command, that when there is a vested contract right in a class of the stockholders to be protected and dealt with, arising independently of the debtor's articles of incorporation, that such right could not be waived, surrendered or abandoned simply because debtor filed its petition under Section 77B. On the contrary, in this case it was reassured and guaranteed to the Class A stockholders that they would be compensated therefor by being permitted to participate in the new company as provided in the 1937 plan. The surrender of that valuable right was their immediate contribution to the reorganization and was not a "nuisance

value" position that these stockholders were giving up. What they had was a promise on the part of the bondholders not to squeeze them out until 1944.

Respondent calls the attention of this Court to the fact that the District Court found [R. p. 327] that the 1937 plan, confirmed in these proceedings, was consented to by the holders of 56,920.180 shares of respondent's Class A stock, representing 98-plus per cent of all of the outstanding Class A stock of respondent. Respondent submits that, as to the Class A stockholders who did not consent to the 1937 plan, either before or after the filing of the 77B proceeding, that, even under the waiver theory adopted by this Honorable Court, said stockholders' rights under the contract still exist and must be dealt with by the District Court in any determination as to the fairness and equitableness of a plan of reorganization. Furthermore, respondent submits that each of said Class A stockholders, whether he consented or not, can and may litigate his claim to his contract right in this proceeding if a plan is not adopted which satisfies him and which compensates and fairly deals with the Class A stockholders as a class on account of their right under the 1930 contract. We can see no program of fair dealing upon which a plan can be confirmed which does not deal with and fairly compensate the Class A shareholders. They, as stockholders, separate and distinct from the corporate entity (respondent) are the holders of a vested contract right which cannot be divested without adequate compensation therefore being afforded the holders thereof.

As stated above, no attempt was made to curtail or broaden the District Court's jurisdiction in

the 77B proceedings by the provisions of the 1937 plan, which was agreed to by more than the requisite majority of affected parties prior to the filing of the petition. The 1937 plan was attached to the petition as an exhibit [R. p. 132] and on January 28, 1938, the District Court entered its order approving said petition as properly filed under Section 77B. On March 18, 1938 [R. p. 133], pursuant to order of the District Court, the modification to the 1937 plan was proposed and filed by debtor. The plan as filed with the original petition and the modification thereof provided, subject to the approval and confirmation by the Court, for the treatment to be accorded to the Class A stockholders for and in consideration of the abrogation of their contract right to postponement of foreclosure until 1944. Such disposition of the stockholders' claim under the contract did not limit the jurisdiction of the Court. On the contrary, it was submitted by the respondent corporation to the Court as a proposed plan which would fairly compensate the Class A stockholders for the surrender of their vested contract right. The District Court, we submit, was not bound by the plan, but if the District Court should have determined to depart from the plan, it would then have been necessary to resubmit the proposition to the Class A shareholders to ascertain whether or not the revised disposition of their claim would receive the necessary majority consent on the part of said shareholders. This procedure, in fact, was followed by the District Court when the modification of the plan was proposed on March 18, 1938 [R. p. 133]. The District Court ordered a notice mailed covering such modification to each Class A shareholder and, under the order, it was provided that said Class A shareholders could withdraw their consents to the plan as the same was modified on or

before April 11, 1938, and Class A stockholders failing to so withdraw would be deemed to have consented to said modification. The Court will recall that, under the modification of the plan, the percentage of participation by the Class A shareholders was substantially reduced. Such reduction gave rise to the Court's order that the modification adversely affected the Class A shareholders and therefore, under the provisions of Section 77B, the modification had to be submitted to said shareholders for reconsideration and vote by them as a class. This procedure, we submit, was fair and equitable and would have been and will be the only fair and equitable procedure upon a modification which further reduces or entirely eliminates the participation of the Class A shareholders.

Respondent takes this position and respectfully urges it before this Court on the ground that the Class A shareholders have a vested right under a contract (independent of their rights as shareholders under respondent's articles of incorporation) and such vested right cannot be divested in the absence of the requisite consents, unless the holders thereof are adequately compensated therefor. The failure of any plan to receive the consent of a majority in amount of the Class A shareholders, we submit, would prevent confirmation thereof.

At page 15 of this Honorable Court's decision a statement is made that "When that jurisdiction attached, the Court, rather than the stockholders, was in control with all of the powers and duties which that entailed under 77B."

As to the vested right of the Class A stockholders based upon the 1930 contract, we submit that the Court's "con-

trol" and disposition thereof was limited by the provisions of the Constitution of the United States as well as the provisions of Section 77B. Certainly, we submit, such vested contract right was not waived by the filing of the 77B petition by respondent corporation. We submit that it is equally certain that the District Court is not accorded, under Section 77B, the power or the duty to approve a plan of reorganization of respondent which would be tantamount to a foreclosure of the trust indenture at this time in contravention of the commitment of the bondholders to the Class A stockholders in the 1930 amendment to the trust indenture which postponed foreclosure until 1944. If the bondholders are to be given all of the benefits of an immediate foreclosure and the provisions of the amendment to the trust indenture are to be done away with, we submit that the Class A stockholders must be fairly and adequately compensated for the waiver of their right to defer foreclosure until 1944.

We would summarize respondent's Point I and respectfully request the Court's pardon for any reiteration or repetition, as follows:

In reaching its decision, this Honorable Court concluded that the right to defer or put off foreclosure until 1944 was "necessarily waived or abandoned on invoking the jurisdiction of the federal court in these proceedings". The respondent corporation (debtor in the District Court) filed the voluntary proceeding under Section 77B. No act of the debtor as a separate legal entity could affect or disturb the vested contract right of its Class A stockholders under an existing contract with its bondholders. The decision

of this Honorable Court merges the respondent corporation and its Class A stockholders and permits an act of the respondent corporation to constitute a waiver of vested rights of its Class A stockholders without said stockholders' consent thereto. Such a decision under the cases pointed out above should only be reached if an inequitable result would flow from the maintenance of the separate entities of the respondent corporation and its Class A stockholders. Respondent submits that a fair and equitable result could be obtained only by honoring the diverse entities and enforcing and placing a value upon the vested right of the Class A stockholders under the 1930 contract and compensating them therefor by permitting them to participate under the plan based upon a surrender and abrogation of their right to postpone foreclosure until 1944.

It is therefore clear to respondent that the decision of this Honorable Court is based squarely upon a surrender of this vested contract right of Class A stockholders brought about by respondent by filing voluntarily under Section 77B. Respondent argued in its reply to the brief of the United States, *amicus curiae*, that any such decision of this Court would bring about an inequitable result. We have briefly again discussed this point herein with the hope that this Court will reconsider its decision and affirm the conclusion of the District Court and the Circuit Court of Appeals for the Ninth Circuit that the consideration flowing from the Class A stockholders to the bondholders was adequate to support the par-

ticipation of the Class A stockholders under the plan and further that the act of the respondent by voluntarily filing a petition under Section 77B did not and could not disturb rights vested in a group, the Class A stockholders, separate from the respondent corporate entity, which right arose under the contract which was the basis of the 1930 reorganization. The Class A stockholders' vested contract right with which we are here concerned did not arise out of the articles of incorporation of respondent corporation, but rather, as stated, is based, upon and flows from the 1930 plan of reorganization agreed to and binding upon respondent corporation's bondholders. This Honorable Court's decision gives the bondholders all of the benefits of an abrogation of said 1930 plan without according to the Class A stockholders of respondent, parties to said plan, any compensation for said abrogation. The 1930 plan cost the contributing Class A stockholders $400,000 in cash for which they received a period of time until 1944 in which to operate without fear of foreclosure. Under the 1937 plan the Class A stockholders agreed to cut this period virtually in half, in consideration of a junior participation in the new company. This Court's decision takes away this vested contract right without providing any compensation whatever therefor. The disposition of this vested contract right under the 1937 plan and the compensation accorded the Class A stockholders was determined to be fair and equitable by the District Court after a full and careful consideration of the evidence, which evidence is not before this Court.

POINT II.

If the Court Will Rule at This Time Upon Two of the Main Contentions of Petitioners Case and Cowan, Future Litigation Based Thereon in This Proceeding May Be Avoided.

Petitioners Case and Cowan claim:

That they are in a class by themselves as the only remaining *bona fide* holders of first mortgage bonds of respondent, are entitled to have the lien of the trust indenture enforced and their bonds paid in full and that any other treatment of them would be violative of the rights vouchsafed to them in their bonds and under the trust indenture if accomplished by amendment of the trust indenture and would not give them "adequate protection" if done under Section 77B for the following reasons:

(1) That they have never consented as bondholders to any reorganization of respondent, either the voluntary one in 1930 or the present proceeding under Section 77B;

(2) That no majority consent of bondholders, however large, whether pursuant to the amendment provisions of the trust indenture as in the 1930 reorganization or pursuant to the provisions of Section 77B as in the present proceeding can bind them.

Respondent, on the contrary, claims:

(1) That the bond issue trust indenture was amended in accordance with the amendment provisions thereof in 1930; and

Therefore, petitioners, even though among the minority of bondholders not consenting thereto, were bound by said amendment;

(2) That in a proceeding under Section 77B, the District Court is empowered to approve a plan which has been consented to by the holders of the requisite percentage of bonds in the class if the plan is found to be fair and feasible and not discriminatory in favor of any class; and

Therefore, petitioners, even though among the minority of non-consenting bondholders of the class of which the requisite majority in amount consented thereto, would be bound by such plan, notwithstanding the fact that their rights are materially altered under such a plan and

(3) That the provisions of subdivision (b)(5) of Section 77B are not applicable where the plan has been consented to by the holders of the requisite amount of bonds in the class.

The District Court ruled in favor of respondent on all of these points [R. pp. 108, 219, 228, 244, 313, 321, 328] and the holding was not disturbed by the Circuit Court [R. pp. 374, 376-380]. Respondent respectfully submits that the decision of this Honorable Court does not decide these points and therefore petitioners or any other bondholders of respondent similarly situated will not be barred from raising the same questions again in this proceeding regardless of whatever plan which treats all of respondent's bondholders alike, may ultimately be approved by the District Court and consented to by the requisite percentage of security holders of respondent.

At page 21 of petitioners' brief in support of their petition for a writ of certiorari, three of petitioners' specifications of error are set forth as follows:

> "1. The Circuit Court of Appeals for the Ninth Circuit erred in concluding under the circumstances disclosed in this case, that petitioners, as dissenting bondholders, should be deprived of and lose their first mortgage lien, their right to foreclose and other substantive rights; [R. 274, 302.]
>
> * * * * * * * *
>
> 3. That the Court erred under the circumstances disclosed in this case, in sustaining a plan that is not fair because no compensation is provided for dissenting bondholders for the loss of their mortgage lien, and a plan which does not afford them the 'adequate protection' required by section 77B, subdivision (b) (5) of the Bankruptcy Act; [R. 275, 303.]
>
> 4. That the Court erred in depriving of their substantive rights, these petitioners as dissenting bondholders, as a minority who are not bound by any majority of consenting bondholders, however large, and that appellants cannot be deprived of their rights as 'non-assenting creditors' by any kind of a contract to which they are not actually a party, even though more than 75 per cent have consented to the proposed plan; [R. 276, 303, 304.]"

It is not necessary for respondent to lengthen this petition by enlarging on this ground for rehearing. A disposition by this Honorable Court of these points urged by petitioners will undoubtedly prevent a duplication of litigation in the lower courts and this Court in this proceeding on these points.

Conclusion.

Respondent respectfully urges this Honorable Court to grant a rehearing in this case on the grounds stated.

FARIES AND MCDOWELL,
DAVID R. FARIES,
J. CLIFFORD ARGUE,
GIBSON, DUNN & CRUTCHER,
J. C. MACFARLAND,
STUART L. LAPP,
Attorneys for Respondent.

Certificate of Counsel, Required by Rule 33.

State of California, County of Los Angeles—ss.

J. C. Macfarland, being first duly sworn, certifies, deposes and says that he is a member of the bar of the Supreme Court of the United States and is one of the attorneys for respondent, Los Angeles Lumber Products Company, Ltd., a corporation, in the proceedings in the Supreme Court of the United States in the above entitled matter; that the within and foregoing petition of respondent for rehearing in said matter is presented in good faith and not for delay.

J. C. MACFARLAND.

Subscribed and sworn to before me this 28th day of November, 1939.

[Seal] C. E. CULVER,
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires: June 24, 1942.

pp. 6, 18, 10

SUPREME COURT OF THE UNITED STATES.

Nos. 23 and 24.—October Term, 1939.

Thomas K. Case and Adele B. Cowan and Estate of Adele B. Cowan, Deceased, Petitioners,
23 *vs.*
Los Angeles Lumber Products Company, Ltd.

Thomas K. Case and Adele B. Cowan and Estate of Adele B. Cowan, Deceased, Petitioners,
24 *vs.*
Los Angeles Lumber Products Company, Ltd.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[November 6, 1939.]

Mr. Justice Douglas delivered the opinion of the Court.

These cases[1] present the question of the conditions under which stockholders may participate in a plan of reorganization under § 77B (48 Stat. 912) of the Bankruptcy Act where the debtor corporation is insolvent both in the equity and in the bankruptcy sense. Because of the contrariety of tendencies in practical administration of the Act among the circuits as illustrated by the differences between the holding below (100 F. (2d) 963) and that in *In re Barclay Park Corp.*, 90 F. (2d) 595, we granted certiorari.

The debtor is a holding company owning all of the outstanding shares of the capital stock (except for certain qualifying shares held by directors) of six subsidiaries. Three of these have no assets of value to the debtor. Two have assets of little value. The debtor's principal asset consists of the stock of Los Angeles Shipbulding and Drydock Corporation which is engaged in shipbuilding and ship

[1] One involves an interlocutory order and the other a final order confirming a plan of reorganization under § 77B of the Bankruptcy Act.

repair work in California. This subsidiary has fixed assets of $430,000 and current assets of approximately $400,000. This subsidiary has only current debts of a small amount, not affected by the plan. The debtor's assets other than the stock of its subsidiaries aggregate less than $10,000.

The debtor's liabilities[2] consist of principal and interest of $3,807,071.88 on first lien mortgage bonds issued in 1924 and maturing in 1944, secured by a trust indenture covering the fixed assets of Los Angeles Shipbuilding and Drydock Corporation (one of the subsidiaries) and the capital stock of all of the subsidiaries. No interest has been paid on these bonds since February 1, 1929. In 1930, as a consequence of the financial embarrassment of the debtor, a so-called voluntary reorganization was effected. To that end, a supplement to this trust indenture was executed, pursuant to a provision therein, with the consent of about 97% of the face value of all the outstanding bonds, which reduced the interest from 7½% to 6% and made the interest payable only if earned. At the same time the old stock of the debtor was wiped out by assessment and new stock issued, divided into Class A and Class B, with equal voting rights. Class A stock was issued to some of the old stockholders who contributed $400,000 new money which was turned over to the Los Angeles Shipbuilding and Drydock Corporation and used by it as working capital. In consideration of this contribution the bondholders who agreed to the modification of the indenture likewise released the stockholders' liability under California law in favor of these contributors. Some Class B stock was issued to bondholders in payment of unpaid interest coupons.[3] At present there are outstanding 57,788 shares of Class A stock and 5,112 shares of Class B stock.

In 1937 the management prepared a plan of reorganization to which over 80% of the bondholders and over 90% of the stock assented. This plan of reorganization, as we shall discuss hereafter,

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[2] Other liabilities, not material here, are $6,075.94 of current accounts payable and $496,899.76 due the Los Angeles Shipbuilding and Drydock Corporation.

[3] A large block of Class B stock was escrowed under a management contract with one Armes to be delivered to him when all the bonds were retired and the Class A stockholders were paid back their $400,000 plus interest in the form of dividends. But this management contract was later terminated and the escrowed Class B stock was returned to the debtor and cancelled. Class A stock was preferred to Class B in the event of liquidation to the amount of $400,000 and interest.

provided for its consummation either on the basis of contract or in a § 77B proceeding, such election to be made by the board of directors. In January 1938 the directors chose the latter course and the debtor corporation filed a petition for reorganization under § 77B of the Bankruptcy Act, with the plan attached and reciting, *inter alia*, that the required percentage of security holders had consented to it. This plan as filed was later modified by the debtor, as we point out later, in a manner not deemed by us material to the issues here involved. That plan as modified provides for the formation of a new corporation, which will acquire the assets of Los Angeles Shipbuilding and Drydock Corporation,[4] and which will have a capital structure of 1,000,000 shares of authorized $1 par value voting stock. This stock is divided into 811,375 shares of preferred and 188,625 shares of common. The preferred stock will be entitled to a 5% non-cumulative dividend, after which the common stock will be entitled to a similar dividend. Thereafter all shares of both classes will participate equally in dividends. The preferred stock will receive on liquidation a preference to the amount of its par value. Thereupon the common will receive a similar preference. Thereafter all shares of both classes participate equally.

170,000 shares of preferred are reserved for sale to raise money for rehabilitation of the yards.[5] 641,375 shares of the preferred are to be issued to the bondholders, 250 shares to be exchanged for each $1000 bond. The Class A stockholders will receive the 188,625 shares of common stock, without the payment of any subscription or assessment. No provision is made for the old Class B stock. The aggregate par value of the total preferred and common stock to be issued to existing security holders is $830,000—an amount which equals the going concern value of the assets of the enterprise.

The plan was assented to by approximately 92.81% of the face amount of the bonds, 99.75% of the Class A stock, and 90% of the Class B stock. Petitioners own $18,500 face amount of the bonds. They did not consent to the so-called voluntary reorganization in 1930 whereby the trust indenture was amended. And throughout

[4] The assets of the debtor, except the capital stock of two subsidiaries which have assets of some, though slight, value will also be transferred to the new company. The assets of these two subsidiaries will be liquidated and the proceeds distributed pro rata among bondholders. The assets of the other three subsidiaries will also apparently be acquired by the new company.

[5] No underwriting of these funds is provided and no disclosure is made as to how the additional funds are to be raised.

the present § 77B proceedings they appropriately objected that the plan was not fair and equitable to bondholders.

The District Court found that the debtor was insolvent both in the equity sense and in the bankruptcy sense. The latter finding was based upon "appraisal and audit reports." In this connection the court found that the total value of all assets of Los Angeles Shipbuilding and Drydock Corporation was $830,000, those assets constituting practically all of the assets of the debtor and of its various subsidiaries of any value to the estate. Yet in spite of this finding, the court, in the orders now under review, confirmed the plan. And the court approved it despite the fact that the old stockholders, who have no equity in the assets of the enterprise, are given 23% of the assets and voting power in the new company without making any fresh contribution by way of subscription or assessment. The court, however, justified inclusion of the stockholders in the plan (1) because it apparently felt that the relative priorities of the bondholders and stockholders were maintained by virtue of the preferences accorded the stock which the bondholders were to receive and the fact that the stock going to the bondholders carried 77% of the voting power of all the stock presently to be issued under the plan; and (2) because it was able to find that they had furnished the bondholders certain "compensating advantages" or "consideration". This so-called consideration was stated by the District Court in substance as follows:

1. It will be an asset of value to the new company to retain the old stockholders in the business because of "their familiarity with the operation" of the business and their "financial standing and influence in the community"; and because they can provide a "continuity of management."

2. If the bondholders were able to foreclose now and liquidate the debtor's assets, they would receive "substantially less than the present appraised value" of the assets.

3. By reason of the so-called voluntary reorganization in 1930, the bondholders cannot foreclose until 1944, the old stockholders having the right to manage and control the debtor until that time. At least the bondholders cannot now foreclose without "long and protracted litigation" which would be "expensive and of great injury" to the debtor. Hence, the virtual abrogation of the agreement deferring foreclosure until 1944 was "the principal valuable

consideration" passing to the bondholders from the old stockholders.

4. Bonding companies are unwilling to assume the risk of becoming surety for the debtor or its principal subsidiary "because of the outstanding bond issue". The government's construction program will provide "valuable opportunities" to the debtor if it is prepared to handle the business. Hence, the value to the bondholders of maintaining the debtor "as a going concern, and of avoiding litigation, is in excess of the value of the stock being issued" to the old stockholders.

The Circuit Court of Appeals in affirming the decree confirming the plan stated that it was not possible for it to do other than accept these findings because of a stipulation and the state of the record thereunder. That stipulation provided for an abbreviated record and stated that the dissenting bondholders intended "to raise questions of substantive law only". But it also specified as errors, *inter alia*, the inclusion of stockholders in a plan where they have no equity and the finding that the plan was "fair" and "equitable". Thereby the stipulation adequately reserved the question of law as to whether on these facts the plan was fair and equitable within the meaning of § 77B. But in any event a stipulation does not foreclose legal questions. *Swift & Co.* v. *Hocking Valley Ry. Co.*, 243 U. S. 281, 289.

On that question of law we think that the District Court erred in confirming the plan and that the Circuit Court of Appeals erred in affirming that decree. We think that as a matter of law the plan was not fair and equitable.

At the outset it should be stated that where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by § 77B(f) for confirmation of the plan has consented. It is clear from a reading of § 77B(f)[6] that the Congress has required both that the required percentages of each class of security holders approve the plan and that the plan be found to be "fair and equitable". The former is not a substitute for the latter. The

[6] It provides in part: "After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible; (2) it complies with the provisions of subdivision (b) of this section; (3) it has been accepted as required by the provisions of subdivision (e), clause (1) of this section; . . ."

court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. This is in line with the decision of this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, which reversed an order approving a plan of reorganization under § 77B, in spite of the fact that the requisite percentage of the various classes of security holders had approved it, on the ground that preferred stock of the debtor corporation was inequitably treated under the plan. The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the function and the duty imposed by the Congress on the district courts under § 77B. That function and duty are no less here than they are in equity receivership reorganizations, where this Court said, "Every important determination by the court in receivership proceedings calls for an informed, independent judgment." *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436.

Hence, in this case the fact that 92.81% in amount of the bonds, 99.75% of the Class A stock, and 90% of the Class B stock have approved the plan is as immaterial on the basic issue of its fairness as is the fact that petitioners own only $18,500 face amount of a large bond issue.

The words "fair and equitable" as used in § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations. Hence, as in case of other terms or phrases used in that section, *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216, we adhere to the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. *Keck* v. *United States*, 172 U. S. 434, 446.

In equity reorganization law the term "fair and equitable" included, *inter alia*, the rules of law enunciated by this Court in the familiar cases of *Railroad Co.* v. *Howard*, 7 Wall. 392; *Louisville Trust Co.* v. *Louisville, New Albany & Chicago Ry. Co.*, 174 U. S. 674; *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482; *Kansas*

City Terminal Ry. Co. v. *Central Union Trust Co.*, 271 U. S. 445. These cases dealt with the precedence to be accorded creditors over stockholders in reorganization plans.[1] In *Louisville Trust Co.* v. *Louisville, New Albany & Chicago Ry. Co., supra*, this Court reaffirmed the "familiar rule" that "the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors." And it went on to say that "any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation" (p. 684). This doctrine is the "fixed principle" according to which *Northern Pacific Railway Co.* v. *Boyd, supra*, decided that the character of reorganization plans was to be evaluated. And in the latter case this court added, "If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event, it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever." (p. 508.) On the reaffirmation of this "fixed principle" of reorganization law in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra*, it was said that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation" (p. 455). In application of this rule of full or absolute priority this Court recognized certain practical considerations and made it clear that such rule did not "require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock." *Northern Pacific Railway Co.* v. *Boyd, supra*,

[1] For analyses and reviews of these cases as applied to equity reorganizations or reorganizations under § 77B and § 77 of the Bankruptcy Act see Frank, Some Realistic Reflections on Some Aspects of Corporate Reorganization, 19 Va. L. Rev. 541; Swaine, Reorganization of Corporations: Certain Developments of the Last Decade, 27 Col. L. Rev. 901; Spaeth and Wiehe, The Boyd Case and Section 77, 32 Ill. L. Rev. 769; Bonbright and Berge, Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization, 28 Col. L. Rev. 127; Friendly, Some Comments on the Corporate Reorganization Act, 48 Harv. L. Rev. 39; 2 Gerdes on Corporate Reorganizations, § 1084.

p. 508. And this practical aspect of the problem was further amplified in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra,* by the statement that "when necessary, they (creditors) may be protected through other arrangements which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right" (pp. 454-455). And it also recognized the necessity at times of permitting the inclusion of stockholders on payment of contributions, even though the debtor company was insolvent. As stated in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra,* p. 455: "Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the Chancellor may exercise an informed discretion concerning the practical adjustment of the several rights." But even so, payment of cash by the stockholders for new stock did not itself save the plan from the rigors of the "fixed principle" of the *Boyd* case, for in that case the decree was struck down where provision was not made for the unsecured creditor and even though the stockholders paid cash for their new stock. Sales pursuant to such plans were void, even though there was no fraud in the decree. *Northern Pacific Railway Co.* v. *Boyd, supra,* p. 504. As this Court there stated, p. 502, "There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree."

Throughout the history of equity reorganizations this familiar rule was properly applied in passing on objections made by various classes of creditors that junior interests were improperly permitted to participate in a plan or were too liberally treated therein. In such adjudications the doctrine of *Northern Pacific Railway Co.* v. *Boyd, supra,* and related cases, was commonly included in the phrase "fair and equitable" or its equivalent. As we have said, the phrase became a term of art used to indicate that a plan of reorganization fulfilled the necessary standards of fairness. Thus throughout the cases in this earlier chapter of reorganization law,

we find the words "equitable and fair",[8] "fair and equitable",[9] "fairly and equitably treated",[10] "adequate and equitable",[11] "just, fair and equitable"[12] and like phrases[13] used to include the "fixed principle" of the *Boyd* case, its antecedents and its successors. Hence we conclude, as have other courts,[14] that that doctrine is firmly imbedded in § 77B.

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[8] Jameson v. Guaranty Trust Co. of New York, 20 F. (2d) 808, 815, certiorari denied 275 U. S. 569.

[9] Flersheim v. National Radiator Corp., 64 F. (2d) 847, 852, rev'd 290 U. S. 504.

[10] P. R. Walsh Tie & Timber Co. v. Missouri Pacific Ry. Co., 280 F. 38, 44.

[11] Mountain States Power Co. v. A. L. Jordan Lumber Co., 293 F. 502, 506.

[12] St. Louis-San Francisco Ry. Co. v. M'Elvain, 253 Fed. 123, 134. See also Guaranty Trust Co. v. Missouri Pacific Ry. Co., 238 Fed. 812, 816, 819.

[13] Northern Pacific Railway Co. v. Boyd, *supra*, spoke of a "fair" offer to the creditor and a "just reorganization" as the prerequisite to validity of the plan (p. 508). Kansas City Terminal Ry. Co. v. Central Union Trust Co., *supra*, said that the offer to the creditor had to be "fair and binding" (p. 452).

[14] See In re Day & Meyer, Murray & Young, 93 F. (2d) 657; Tellier v. Franks Laundry Co., 101 F. (2d) 561; In re Philadelphia & Reading Coal & Iron Co., 105 F. (2d) 257; In re New York Railways Corp., 82 F. (2d) 739, 744; 2 Gerdes on Corporate Reorganizations, § 1085. Intimations to the contrary, Downtown Investment Association v. Boston Metropolitan Buildings, Inc., 81 F. (2d) 314, 323-324; In re A. C. Hotel Co., 93 F. (2d) 841, are not tenable.

The statutory scheme of § 77B (in those respects which are material here) is in sharp contrast to that which was provided for compositions under former § 12. This court said in Callaghan v. Reconstruction Finance Corp., 297 U. S. 464, 470: "Reorganizations now permitted under § 77B present certain resemblances to compositions under § 12, which have been commented upon as supporting the constitutionality of the reorganization provisions of § 77 or § 77B. . . . But § 77B contemplates a procedure and results not permissible under § 12. Reorganizations are nowhere referred to in the statute as compositions." Under § 12(a) (as it existed at the time § 77B was enacted) only a "bankrupt" could offer "terms of composition to his creditors". Under § 77B(d) plans may be proposed not only by the debtor but also by a designated percentage of the creditors or, where the debtor is not found to be insolvent, by a specified percentage of stockholders. Section 12(d) as it then existed provided that the judge "shall confirm a composition if satisfied" *inter alia* that "it is for the best interests of the creditors". See Fleischmann & Devine, Inc. v. Saul Wolfson Dry Goods Co., Inc., 299 Fed. 15. The "fair and equitable" standard employed in § 77B was not then present in § 12. Consent by the debtor to the composition was implicit in former § 12 (*cf.* In re Bryer, 281 Fed. 812). But under § 77B approval of a plan by security holders who have no equity in the enterprise is unnecessary. In re 620 Church Street Building Corp., 299 U. S. 24. The general view was well expressed in In re Dutch Wooderaft Shops, 14 F. Supp. 467, 469, "The preservation of business enterprises must not be at the expense of creditors, and the provisions of section 77B should not be taken advantage of to effect what, in fact, amounts to a composition under section 12."

The Chandler Act, c. 10 (52 Stat. 840) approved June 22, 1938, now supplants § 77B. Various substantial changes in the provisions of § 77B have been made therein. But the standard of "fair and equitable" as used in § 77B remains unaltered as one of the criteria necessary for confirmation of a plan of reorganization. § 221(2).

We come then to the legal question of whether the plan here in issue is fair and equitable within the meaning of that phrase as used in § 77B.

We do not believe it ~~was~~ is for the following reasons. Here the court made a finding that the debtor is insolvent not only in the equity sense but also in the bankruptcy sense. Admittedly there are assets not in excess of $900,000, while the claims of the bondholders for principal and interest are approximately $3,800,000. Hence even if all of the assets were turned over to the bondholders they would realize less than 25 per cent on their claims. Yet in spite of this fact they will be required under the plan to surrender to the stockholders 23 per cent of the value of the enterprise.

True, the relative priorities of the bondholders and the old Class A stockholders are maintained by virtue of the priorities accorded the preferred stock which the bondholders are to receive. But this is not compliance with the principle expressed in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra,* that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation", for there are not sufficient assets to pay the bondholders the amount of their claims. Nor does this plan recognize the "equitable right" of the bondholders "to be preferred to stockholders against the full value of all property belonging to the debtor corporation", within the meaning of the rule announced in that case, since the full value of that property is not first applied to claims of the bondholders before the stockholders are allowed to participate. Rather it is partially diverted for the benefit of the stockholders even though the bondholders would obtain less than 25% payment if they received it all. Under that theory all classes of security holders could be perpetuated in the new company even though the assets were insufficient to pay—in new bonds or stock—the amount owing senior creditors. Such a result is not tenable.

It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Railway Co.* v. *Boyd, supra,* and *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra.* Especially in the latter case did this Court stress the necessity, at times, of seeking new money "essential to the success of the undertaking"

from the old stockholders.[15] Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made. But if these conditions are not satisfied the stockholder's participation would run afoul of the ruling of this Court in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra*, that "Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances" (p. 456). If, however, those conditions we have mentioned are satisfied, the creditor cannot complain that he is not accorded "his full right of priority against the corporate assets". If that were not the test, then the creditor's rights could be easily diluted by inadequate contributions by stockholders. To the extent of the inadequacy of their contributions the stockholders would be in precisely the position which this Court said in *Northern Pacific Railway Co.* v. *Boyd, supra*, the stockholders there were in, viz., "in the position of a mortgagor buying at his own sale" (p. 504).

In view of these considerations we believe that to accord "the creditor his full right of priority against the corporate assets" where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

The alleged consideration furnished by the stockholders in this case falls far short of meeting those requirements.

1. The findings below that participation by the old Class A stockholders will be beneficial to the bondholders because those stockholders have "financial standing and influence in the community" and can provide a "continuity of management" constitute no legal

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[15] This new money was commonly necessary in equity reorganizations not only to provide new working capital but also to pay dissenting creditors. See Weiner, Conflicting Functions of the Upset Price in a Corporate Reorganization, 27 Col. L. Rev. 132.

Like considerations are relevant in reorganizations under § 77B. As stated by the court in In re Dutch Wooderaft Shops, 14 F. Supp. 467, 471:

"Circumstances may exist where the success of an undertaking requires that new money be furnished and where the former stockholders are the only or most feasible source of the new capital. In such instances, the court may recognize as fair and equitable a plan which includes contributions of new money by stockholders, provided it satisfactorily appears that full recognition has been given to the value of creditors' claims against the property."

justification for issuance of new stock to them. Such items are illustrative of a host of intangibles which, if recognized as adequate consideration for issuance of stock to valueless junior interests, would serve as easy evasions of the principle of full or absolute priority of *Northern Pacific Railway Co.* v. *Boyd, supra,* and related cases. Such items, on facts present here, are not adequate consideration for issuance of the stock in question. On the facts of this case they cannot possibly be translated into money's worth reasonably equivalent to the participation accorded the old stockholders. They have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities.[16] As such, they cannot be the basis for issuance of stock to otherwise valueless interests. The rigorous standards of the absolute or full priority doctrine of the *Boyd* case will not permit valueless junior interests to perpetuate their position in an enterprise on such ephemeral grounds.[17]

2. The District Court's further finding that if the bondholders were to foreclose now they would receive "substantially less than the present appraised value" of the assets of the debtor corporation is no support for inclusion of the old stockholders in the plan. The fact that bondholders might fare worse as a result of a foreclosure and liquidation than they would by taking a debtor's plan under § 77B can have no relevant bearing on whether a proposed plan is "fair and equitable" under that section. Submission to coercion is not the application of "fair and equitable" standards. Such a proposition would not only drastically impair the standards of "fair and equitable" as used in § 77B; it would pervert the function of that Act. One of the purposes of § 77B was to avoid

[16] On comparable facts a like conclusion was reached in In re Barclay Park Corp., 90 F. (2d) 595, where the court said, p. 598:

"It is argued that the stockholders represent the present management of the hotel and that the management is valuable and indeed necessary to the enterprise and that the manager-stockholders will 'walk out' if the proposed plan does not go through and leave the hotel to its fate. But there is no binding agreement on their part to remain which might afford a justification for giving them a stock interest and, if their managerial skill is vital to the success of the hotel, any stock issued to insure the continuance of their relation ought to go to those stockholders who are of use to the enterprise and agree to act in its behalf, and not to all stockholders as such. Indeed, the supposed advantages of retaining the existing management seem to be a matter of inference, if not of speculation, supported by the oral statements of attorneys instead of by testimony."

[17] This conclusion is reemphasized here by the fact that not all of the Class A stockholders who receive new stock are part of the management of the debtor.

the consequences to debtors and creditors of foreclosures, liquidations, and forced sales with their drastic deflationary effects.[18] To hold that in a § 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders because apart from rehabilitation under that section they would suffer a worse fate, would disregard the standards of "fair and equitable"; and would result in impairment of the Act to the extent that it restored some of the conditions which the Congress sought to ameliorate by that remedial legislation.

3. The conclusion of the District Court that the virtual abrogation of the agreement deferring foreclosure until 1944 ("the principal valuable consideration" given to the bondholders by the stockholders) justified participation by the stockholders in the plan is likewise erroneous.

What were the rights of the bondholders under the supplemental indenture executed in 1930 we cannot determine. That indenture is not in the abbreviated record before us. The District Court found that for all practical purposes the bondholders could not foreclose until 1944. From the findings below we conclude that that followed as a consequence of making interest payable only if earned. On this record it does not appear whether or not there might be other events of default—such as non-payment of sinking funds—giving bondholders or the trustee the right to foreclose or giving bondholders or the trustee the right to accelerate the maturity of the bonds so that suits could be brought thereon. Hence, we must assume, as the District Court found, that the bondholders and the trustee could not take possession of the property through foreclosure or otherwise until the maturity of the bonds. And as a corollary thereof we likewise assume that the stockholders, at least so far as the bondholders were involved, could keep their management group in possession and control until that time. And we assume that this right or power on the part of the stockholders to keep possession until 1944 was for them a thing of value, though there is no finding that the old stock had any value, present or prospective.

But we cannot conclude that that right survived the commencement of the proceedings under § 77B. A debtor as well as a creditor who invokes the aid of the federal courts in reorganization or rehabilitation under § 77B assumes all of the consequences which flow from that jurisdiction. Once the property is in the hands of

[18] See H. R. Rep. No. 1409, 75th Cong., 1st Sess., p. 38, dealing with recent amendments to the section; and H. R. Rep. No. 194, 73rd Cong., 1st Sess., p. 2, the report accompanying the original Act.

the court private rights as respect that *res* are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by the Congress. As a result of such proceedings the hand of all executions or levies may be stayed.[19] The court acquires "exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section."[20] The court need not keep the debtor in possession but may substitute for the old management a trustee; or if the old management is retained it operates the business "subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as the judge may from time to time impose and prescribe".[21] Thus, while the property remains in the hands of the court, as it does until dismissal or final decree on confirmation, the debtor, though left in possession by the judge, does not operate it, as it did before the filing of the petition, unfettered and without restraint. The control of the court is then pervasive.[22] Furthermore stockholders and other junior interests may be excluded from any plan of reorganization if the court finds that the debtor is insolvent. *In re 620 Church Street Building Corp.*, 299 U. S. 24. And on facts such as exist here, these junior interests must be excluded unless they furnish adequate consideration for the interest which

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19 Section 77B(a), (c)(10) Cf. Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648.

20 Section 77B(a).

21 Section 77B (c).

22 See, 1 Gerdes on Corporate Reorganizations, c. 9. These powers embrace not only the specifically enumerated powers contained in § 77B but also "all the powers, not inconsistent with this section, which a Federal court would have had it appointed a receiver in equity of the property of the debtor by reason of its inability to pay its debts as they mature." § 77B(a). In addition, by virtue of § 77A the district court, as a court of bankruptcy, has original jurisdiction in proceedings under § 77B. Illustrative of specific powers granted by § 77B are the powers of the court to authorize issuance of certificates (§ 77B (c)(3)), to require the filing of schedules and reports (§ 77B (c)(4)), to direct rejection of executory contracts (§ 77B (c)(5)), to control salaries of officers and to approve appointments "to any office" (§ 77B(c)). The last subsection also provides, "In case a trustee is not appointed, the debtor shall continue in the possession of its property, and, if authorized by the judge, shall operate the business thereof during such period, fixed or indefinite, as the judge may from time to time prescribe, and shall have all the title to and shall exercise, consistently with the provisions of this section, all the powers of a trustee appointed pursuant to this section, subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as the judge may from time to time impose and prescribe." In the instant case the court left the debtor in possession, allowing its officers no salaries but allowing specified salaries to be paid to designated officers of the principal subsidiary.

they obtain in the new company. And once the jurisdiction of the court has been invoked, whether by the debtor or by a creditor, that petitioner cannot withdraw and oust the court of jurisdiction.[23] He invokes that jurisdiction risking all of the disadvantages which may flow to him as a consequence, as well as gaining all of the benefits. One of those disadvantages from the viewpoint of the debtor and its stockholders is the approval of a plan of reorganization which eliminates them completely.[24] Accordingly, respondent's assertion in this case that the major contribution of these stockholders justifying their inclusion in the plan was the waiver of their right to defer or put off foreclosure until 1944, i.e., to remain in possession, does not stand analysis. The right to remain in unmolested dominion and control over the property was necessarily waived or abandoned on invoking the jurisdiction of the federal courts in these proceedings. When that jurisdiction attached, the court rather than the stockholders was in control with all of the powers and duties which that entailed under § 77B. Certainly the surrender of a right thus waived is not adequate consideration for the dilution of the bondholders' priorities which this plan would effect.

And there is a further reason why this result necessarily follows, if the will of the Congress as expressed in § 77B is not to be thwarted and if the integrity of such proceedings is to be maintained. As we have said, this plan had its origin in an endeavor on the part of the debtor in 1937 to effect a voluntary reorganization. A plan was proposed by the debtor which was the same as that here involved except for the amount and nature of the stock to be received by the bondholders.[25] That plan contained two methods for its consummation. The first was by means of an amendment to the trust indenture and a recapitalization of the debtor, a method to be followed if the board felt that sufficient approvals had been obtained. The second was by means of § 77B.

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[23] The Act has explicit standards for dismissal (§ 77B (c)(8)) which we discuss hereafter.

[24] As recognized in In re 620 Church Street Building Corp., *supra*, § 77B (c)(1) expressly takes care of this contingency in the provision that acceptance of the plan by a majority of the stock "shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders (1) if the judge shall have determined" inter alia, that "the debtor is insolvent."

[25] Under that plan the new company was to have an authorized capital of $1,000,000 consisting of 1,000,000 shares of a par value of $1.00 per share, the bondholders getting 590,065 of the shares and the old Class A stockholders getting 239,935 of the shares. Shares going to the bondholders were of the same class as those received by stockholders.

Over 80% of the bondholders and over 90% of the stock approved the original plan. Thereupon the debtor filed its petition in § 77B. Thereafter, the debtor filed a modification of the plan to which the assents, here relied upon, were obtained.[26] Thus respondent argues that since the plan of reorganization was entered into between the bondholders and the stockholders before institution of the reorganization proceedings under § 77B, the consideration flowing from the stockholders had been furnished and the interests of the bondholders and stockholders in the assets of the debtor had been fixed prior to the filing of the petition. In fact, respondent frankly insists that the stockholders' "right of participation was secured by contract before, and as a condition precedent to, the institution of the 77B proceedings."

But the mere statement of this proposition is its own refutation. If the reorganization court were bound by such conventions of the parties, it would be effectively ousted of important duties which the Act places on it. Federal courts acting under § 77B would be required to place their imprimatur on plans of reorganization which disposed of the assets of a company not in accord with the standards of "fair and equitable" but in compliance with agreements which the required percentages of security holders had previously made. Such procedure would deprive scattered and unorganized security holders of the protection which the Congress had provided them under § 77B. The scope of the duties and powers of the Court would be delimited by the bargain which reorganizers had been able to make with security holders before they asked the intercession of the court in effectuating their plan. Minorities would have their fate decided not by the court in application of the law of the land as prescribed in § 77B, but by the forces utilized by reorganizers in prescribing the conditions precedent on which the benefits of the statute could be obtained. No conditions precedent to enjoyment of the benefits of § 77B can be provided except by the Congress. To hold otherwise would be to allow reorganizers to rewrite it so as to best serve their own ends.[27]

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[26] These assents were apparently measured by the failure of the bondholders to withdraw their consents which had been given to the original plan, on receiving copies of the proposed modification.

[27] Cf. Hollister v. Stewart, 111 N. Y. 644, where the court struck down a voluntary reorganization which attempted to bind minority bondholders. The court said "Unless railroad syndicates or committees are to be put above the Constitution, the trustees cannot set aside and change their contract with plaintiff, of their own volition, without his consent." (p. 660.)

4. The holding of the District Court that the value to the bondholders of maintaining the debtor as a going concern and of avoiding litigation with the old stockholders justifies the inclusion of the latter in the plan is likewise erroneous. The conclusion of the District Court that avoidance of litigation with the stockholders gave validity to their claim for recognition in the plan involves a misconception of the duties and responsibilities of the court in these proceedings. Whatever might be the strategic or nuisance value of such parties outside of § 77B is irrelevant to the duties of the court in confirming or disapproving a plan under that section. In these proceedings there is no occasion for the court to yield to such pressures. If the priorities of creditors which the law protects are not to be diluted, it is the clear duty of the court to resist all such assertions. Of course, this is not to intimate that compromise of claims is not allowable under § 77B. There frequently will be situations involving conflicting claims to specific assets which may, in the discretion of the court, be more wisely settled by compromise rather than by litigation. Thus, ambiguities in the wording of two indentures may make plausible the claim of one class of creditors to an exclusive or prior right to certain assets as against the other class in spite of the fact that the latter's claim flows from a first mortgage.[28] Close questions of interpretations of after-acquired property clauses in mortgages, preferences in stock certificates, divisional mortgages and the like will give rise to honest doubts as to which security holders have first claim to certain assets. Settlement of such conflicting claims to the *res* in the possession of the court is a normal part of the process of reorganization. In sanctioning such settlements the court is not bowing to nuisance claims; it is administering the proceedings in an economical and practical manner. But that is not the situation here. As a result of the filing of the petition in this case, the court, not the stockholders, acquired exclusive dominion and control over the estate. Hence, any strategic position occupied by the stockholders prior to these proceedings vanished once the court invoked

[28] That would appear to be essentially the type of case involved in In the Matter of Detroit International Bridge Co., Debtor, No. 24131, U. S. D. C. E. D. Mich., cited to us by the respondent and described in an advisory report (Corporate Reorganization Release No. 9) submitted by the Securities and Exchange Commission pursuant to § 172, c. X of the Chandler Act. However, the action of the court, if any, on the plan has not yet appeared in the published reports.

its jurisdiction. Threats by stockholders of the kind here in question are merely threats to the jurisdiction of the court, which jurisdiction these selfsame stockholders invoked for their benefit when they caused the debtor's petition to be filed. Consequently, these claims of the stockholders are, as we have said, entitled to no more dignity than any claim based upon sheer nuisance value.

In this connection it should be observed that the finding of the court that it was important to admit the stockholders to participation in the plan so as to maintain the debtor as a going concern and thus protect the bondholders was based upon a misconception of its legal powers and duties. For the court assumed that the only alternative to acceptance of this debtor's plan was a dismissal of the proceeding or a liquidation. But this is not true. In the first place, no special perquisites (of consequence here) flow to stockholders by virtue of the fact that the proceedings are instituted by a voluntary rather than an involuntary petition. The criteria for exclusion or inclusion of stockholders in a plan are precisely the same in both situations. In practice it is not infrequent to find proceedings which start with a debtor's petition ending up with plans of reorganization which exclude stockholders. *In re Reading Hotel Corp.*, 89 F. (2d) 53. In the second place, failure to accept this plan does not force dismissal or liquidation. Section 77B(c)(8) gives the court explicit powers where "a plan of reorganization is not proposed or accepted within such reasonable period as the judge may fix" either to "extend such period" or to "dismiss the proceeding" or, with exceptions not relevant here, to cause liquidation, such choice to be made "as the interests of the creditors and stockholders may equitably require". Accordingly, dismissal has not infrequently been properly denied. *In re Bush Terminal Co.*, 84 F. (2d) 984. And in this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted nor that all reasonable time for proposal of such alternative plans has expired.

We therefore hold that the plan is not fair and equitable and that the judgment below must be and is

Reversed.

Mr. Justice BUTLER took no part in the consideration or disposition of this case.